



Legal Office
P.O. Box 942707
Sacramento, CA 94229-2707
(916) 795-3675, FAX (916) 795-3659

September 16, 2008

AGENDA ITEM #3

**TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION
COMMITTEE**

- I. SUBJECT:** Proposed Policy on Disclosure of Communications
- II. PROGRAM:** Administration
- III. RECOMMENDATION:** Staff recommends that the Committee adopt the policies described in Section E, which are based, in part, on policies adopted by CalSTRS. If the Committee accepts the Staff recommendation, Staff will provide actual policy language at the next Committee meeting.

IV. ANALYSIS:

A. Executive Summary

California public officials and employees are governed by a myriad of statutes, regulations, and policies that restrict gifts, campaign contributions and communications. These rules are intended to limit improper influence and to improve transparency in governmental decision-making. As the Committee will recall, the California State Teachers Retirement System (CalSTRS) has, over the past two years, taken several actions to adopt policies and regulations to supplement the ethical rules imposed by state law. CalPERS legal staff has monitored and informed the Committee of CalSTRS' activities in this area; the most recent update was provided at the Committee's meeting in May, 2008.

At the Committee's May 2008 meeting, the Committee directed staff to recommend, for future discussion and consideration by the Committee, a policy requiring disclosure of communications between board members and third parties, and between board members or third parties and staff. The Committee also asked to receive information regarding what other public pension systems have adopted on this subject.

B. Existing State Law and CalPERS Policy Regarding Disclosure of Communications

1. Award of Vendor Contracts; Communications Prohibited

California law provides that during the process leading to an award of any contract by CalPERS, no member of the board or its staff may knowingly communicate concerning any matter relating to the contract or selection process with any party financially interested in the contract or an officer or employee of that party, unless the communication is (a) part of the process expressly described in the request for proposal or other solicitation invitation, or (b) part of a noticed board meeting. Excluded from this prohibition are (a) communications that are incidental, exclusively social, and do not involve CalPERS or its business or the board or staff member's role as a system official, and (b) communications that do not involve CalPERS or its business and that are within the scope of the board or staff member's private business or public office wholly unrelated to CalPERS. (California Government Code §20153(a) and (c).)

In January 2000, CalPERS adopted a policy interpreting Government Code section 20153. This policy interprets "process leading to an award of a contract by CalPERS," as used in the statute, to begin on the date that a solicitation document is issued and to conclude on the date the Board makes the contract award decision. Attachment 1 contains a copy of this policy.

2. Investment Transactions; Disclosure of Communications

The law also provides that during the evaluation of any prospective investment transaction, no party who is financially interested in the transaction, or an officer or employee of that party, may knowingly communicate with any board member concerning any matter relating to the transaction or its evaluation, unless the financially interested party discloses the content of the communication in writing addressed and submitted to the executive officer and the Board prior to the Board's action on the prospective transaction. The board member who participates in the communication must also disclose the communication to the executive officer and the Board prior to the Board's action on the prospective transaction. The written disclosure must include the date and location of the communication and the substance of the matters discussed. In addition, the disclosed communications must be made public either at the open meeting of the Board in which the transaction is considered, or if in closed session, upon public disclosure of any closed session votes concerning the investment transaction. (California Government Code §20153(b).)

The disclosure requirements applicable to prospective investment transactions do not apply to (a) communications that are part of a noticed board meeting, (b) communications that are incidental, exclusively social, and do not involve CalPERS or its business or the board or staff member's role as a system official, or (c) communications that do not involve CalPERS or its business and that are within the scope of the board or staff member's private business or public office wholly unrelated to CalPERS. (California Government Code §20153(b) and (c).)

The law requires the Board to prescribe procedures concerning the written disclosures by the financially interested parties and by the board members and the procedures that will apply to board members who fail to disclose communications as required by the law. The law also requires the Board to determine the appropriate remedy for any knowing failure of a financially interested party to comply with disclosure requirement, including but not limited to, outright rejection of the prospective investment transaction, reduction in the fee received or any other sanction. (California Government Code §20153(b).)

The policy adopted by CalPERS in January 2000 interpreting Government Code section 20153 also adopted forms for the required disclosures. In addition, the policy provides that the evaluation period for a prospective investment transaction begins when it is listed in the monthly activity report prepared for the Investment Committee and ends when the transaction is either approved or rejected. The monthly activity reports list the principals who are directly involved in a transaction and any placement agent(s), if known, as the financially interested parties. Disclosure is required when the transaction appears on the Investment Committee agenda for action. (See Attachment 1.)

3. CalPERS Statement of Governance Principles

The Statement of Governance Principles adopted by the Board in October 1995, as revised in April 1997, December 1997, October 2001 and April 2007, provide all of the following with respect to Board member communications:

- Board members have no obligation to meet with or communicate with advisors, managers, consultants, contractors or vendors. Any contacts and communications between individual Board members and advisors, managers, consultants, contractors and vendors to CalPERS shall be at the option, discretion, and judgment of each Board member. Individual Board members shall avoid favoritism, conflicts and disclosure of privileged information and at all times individual Board members shall act in the best interest of CalPERS consistent with his/her fiduciary duty. (Section III. C.)

- Individual Board members shall refer proposals or other communications regarding potential or existing investments or other contracts directly to the Chief Executive Officer. (Section III. F.)
- Whenever CalPERS is in the process of selecting or employing advisors, managers, consultants, contractors or vendors, individual Board members shall limit their communications with any person or entity (or agent for such person or entity) that may be under consideration in such selection or hiring process, in a manner that is consistent with the Board's procurement policies. Any Board member who becomes aware of a contact by a person or entity (or agent for such person or entity) that the Board member reasonably believes violates the procurement policies shall report the contact to the Board's President. The Board President shall inform the Chief Executive Officer of the contact, who is responsible for responding in accordance with the Board's procurement policies. (Section III. G.)
- Individual Board members should direct questions regarding specific agenda items to the highest-ranking executive who signed the item or, if appropriate, to the outside consultant who signed the consultant report accompanying the item. (Section III. J. 3.)
- Individual Board members shall not participate in routine staff meetings or other staff activities unless specifically requested by a member of the Executive Staff. (Section III. J. 4.)

A copy of Section III of the Board's Statement of Governance Principles is included in Attachment 2.

C. CalSTRS' Disclosure of Communications Policy

In November 2006, CalSTRS adopted amendments to its policy on disclosure of communications regarding investment transactions. The policy includes and expands upon all of the requirements of Government Code section 20153 applicable to investment transactions. It does not cover or address the communication prohibitions of Section 20153 applicable to vendor contracts (see Section B.1., above). Attachment 3 contains a copy of CalSTRS' policy regarding the Disclosure of Communications.

1. Communications Between Third Parties and Board Members Regarding Investment Transactions

In addition to the requirements of Section 20153 with respect to disclosure of communications regarding investment transactions, the CalSTRS communication policy includes all of the following additional requirements or differences:

- The written disclosure of communications is made to the General Counsel (rather than Chief Executive Officer) and the CalSTRS board.
- The disclosure is required not later than five working days prior to the noticed board meeting at which the investment transaction is being considered unless the communication occurs less than five working days before the noticed board meeting, in which case the disclosure is required immediately after the communication occurs.
- In addition to the communications excluded by section 20153, the CalSTRS policy also excludes communications that are “general in nature and content, such as (1) those with regard either to the nature of the party’s business or interests or with regard to public information regarding CalSTRS; (2) a simple expression of the party’s interest generally in doing business with CalSTRS or having CalSTRS invest in or with the party communication with the board member; or (3) a simple expression by the board member in relation to the performance of an investment or service provided to CalSTRS.”
- Alleged failures of a board member to disclose communications as required must be referred to the chairperson for appropriate action unless the chairperson is a party to the communication in question, in which case the matter must be referred to the vice-chair.
- The communication disclosure requirements are extended (beyond that which is required by law) to apply to investment transactions that do not require investment committee approval, that is, to investment transactions for which the chief investment officer has been delegated the authority to approve the transaction without investment committee approval. For these communications, the disclosure obligation is on the financially interested party only, and not on the board member.
- The General Counsel is required to provide the board with an annual summary of all of the communications disclosed pursuant to the provisions of the policy.

2. Communications Between Board Members and Staff Regarding Investment Transactions

CalSTRS also adopted a policy requiring disclosure of communications between board members and CalSTRS staff. The policy requires that any communication regarding a potential investment transaction initiated by a board member with either a CalSTRS employee or consultant in which the board member is advocating for a specified outcome to be documented by the CalSTRS employee or consultant and reported to the general counsel.

The general counsel is required to disclose the communication to the board if and when, in the judgment of the general counsel, the communication may be material to the board's deliberation with respect to any CalSTRS matter.

3. Communications Involving Undue Influence

Finally, CalSTRS adopted a policy for disclosure of communications that rise to the level of undue influence. The policy provides that any staff member or board member who believes that he or she has been subject to the attempted exercise of undue influence should report the occurrence immediately to his or her branch deputy chief executive officer or the Chief Investment Officer and to the General Counsel. The General Counsel is required to investigate the situation immediately and is authorized to use the services of an outside law firm to conduct the investigation if he or she deems it appropriate. Following such investigation, if the General Counsel concludes that an exercise of undue influence was attempted, he or she shall take whatever action deemed to be appropriate, which includes notifying the board, and thereafter, public disclosure during an open session meeting of the board.

The policy defines undue influence as the employment of any improper or wrongful pressure, scheme or threat by which one's will is overcome and he or she is induced to do or not do an act which he or she would not do, or would do, if left to act freely.

D. Other Public Pension System Policies

An informal survey was conducted of other public pension systems in order to determine whether other systems have adopted policies requiring the disclosure of communications. Few responses were received in response to our inquiry and a few systems responded that they had no such policy.¹

¹ The Sonoma County Employees' Retirement Association, the New York City Pension Plan, and the City of Tacoma system responded that they have no such policies. The State Retirement Agency of Maryland responded that it has a policy prohibiting staff from trading in public securities and that Maryland's ethics law prohibits self-dealing by trustees.

Based on our informal survey, the Teacher Retirement System of Texas appears to have the most comprehensive communication disclosure requirement. CalSTRS' policy was based, in large part, upon the Texas policy, and they are therefore very similar. Neither CalSTRS nor the Teachers Retirement System of Texas surveyed other systems as part of their processes of adopting communication disclosure policies.

The Denver Employees Retirement Plan responded that it prohibits communications between its trustees and a prospective vendor, consultant, agent or intermediary unless the trustee has the prior approval of the board secretary or chairperson.

The Virginia Retirement System responded that its individual board members are prohibited from giving orders or directions to system staff and are prohibited from becoming involved in operational management. Board members are required to refer all proposals or other communications regarding potential or existing investments or contracts or services to the chief investment officer or the director. In addition, whenever the board, the director or the chief investment officer is involved in the selection or employment of advisors, managers, consultants, contractors or vendors, individual board members are prohibited from communicating with regard to the contract with any person who may be under consideration in the selection or hiring process prior to the actual selection or hiring.

E. Staff Recommendations Regarding a Policy on Disclosure of Communications

Staff recommends adopting the CalSTRS' policies regarding communication disclosures with the differences noted below.

First, we recommend that the policy requiring disclosure of communications between board members and staff apply to prospective vendor contracts, in addition to prospective investment transactions. Staff recommends that the policy require disclosure of all board member initiated communications with CalPERS staff or consultants concerning prospective vendor contracts that are not simple requests for information by the board member. Staff recommends that all these communications be disclosed by the CalPERS staff or consultant to the Chief Executive Officer and the General Counsel, and thereafter reported to the Board by the Chief Executive Officer or the General Counsel.

Second, staff recommends that the Board Governance Principles be revised to provide that all board member communications regarding potential investment transactions should be directed to the Chief Investment Officer or the Chief

Operating Investment Officer (rather than the Chief Executive Officer). In addition, staff recommends that the policy on disclosure of communications require Investment Office staff and consultants to notify either the Chief Investment Officer or the Chief Operating Investment Officer, and the General Counsel, of any board member initiated communications with Investment Office staff or consultants regarding a prospective investment transaction or the hiring, termination or funding of an investment money manager, other than simple requests for information by the board member. The Chief Investment Officer, the Chief Operating Investment Officer or the General Counsel will thereafter report such communications to the Board. Staff believes this process would reduce the number of communications between board members and Investment Office staff and consultants, relieve Investment Office staff when such communications do occur of the burden of deciding whether the board member's communication constituted advocacy for a specified outcome, relieve the General Counsel of the burden of deciding what communications are material or nonmaterial, and ensure consistent handling and reporting of board member inquiries.

Third, if any staff member or board member believes he or she has been subjected to the attempted exercise of undue influence, he or she should report the occurrence to the Chief Executive Officer and the General Counsel, if the communication relates to a prospective vendor contract, or to the Chief Investment Officer or Chief Operating Investment Officer and the General Counsel, if the communication relates to a prospective investment transaction or to the hiring, termination or funding of a money manager. The General Counsel will investigate the situation immediately, and following such investigation, if the General Counsel concludes that an exercise of undue influence was attempted, he or she shall take whatever action deemed to be appropriate, which will include notifying the Board, and thereafter, public disclosure during an open session meeting of the Board.

Finally, we do not recommend adopting the CalSTRS' exception to disclosure requirements for certain communications between third parties and board members that are "general in nature and content." We find the CalSTRS exception to be ambiguous and believe that the exceptions stated in Government Code Section 20153 are sufficient.

Staff will provide actual policy language based on the aforementioned recommendations or in accordance with the Committee's direction at the next Committee meeting.

V. STRATEGIC PLAN:

This supports Goal II of the Strategic Plan which calls for CalPERS, as an organization to "foster a work environment that values quality, respect, diversity, integrity, openness, communication, and accountability.

GINA M. RATTO
Deputy General Counsel

PETER H. MIXON
General Counsel